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**REPORT TO THE COMMITTEE ON RULES,
FINANCE AND INTERGOVERNMENTAL RELATIONS**

**STATUS OF PROCEEDINGS AND ACTIONS OF THE CITY
OF SAN DIEGO CONCERNING THE CALIFORNIA ELECTRICITY CRISIS**

INTRODUCTION

In response to the California energy crisis the City of San Diego has undertaken a variety of actions in the various proceedings before both the Federal Energy Regulatory Commission [FERC] and the California Public Utilities Commission [CPUC]. This Report will provide an update on certain of those activities, primarily before FERC, and recommend other actions in response to the energy crisis.

BACKGROUND

As is well known, the California effort to deregulate the electricity marketplace resulted in dramatically higher prices in the San Diego region last summer, and continues to threaten shortages, brownouts and rolling blackouts throughout the state even today. The state legislature attempted to address the cost impact by reimposing a rate cap for customers of San Diego Gas & Electric Company [SDG&E]. However, the economic imbalance created by capping rates that may be charged by the three big investor owned utilities [IOUs] in the state (SDG&E, Southern California Edison [SCE] and Pacific Gas & Electric Company [PG&E]) while requiring them to purchase power at higher, market-based wholesale rates has raised questions about the IOUs ability to survive economically. The Secretary of the federal Department of Energy attempted to address the supply issue last December on a very short term basis by requiring electricity wholesalers to sell electricity to the California market, but FERC has taken no meaningful steps to address the cost of wholesale electricity. The long term supply issue remains in question.

How did California, and San Diego in particular, come to this? The answer is long and complicated. An article appearing last December in the Los Angeles Times provides a very good overview of the historical transition to a deregulated market, the forces that drove the deregulation effort, and the consequences of significant miscalculations by the architects of deregulation. A copy of that article is enclosed for your review as Attachment A.

THE INITIAL RESPONSE TO THE CRISIS

When prices began to spike last summer in San Diego, the Utility Consumers Action Network [UCAN] filed an emergency petition at the CPUC to cap rates for customers. The petition proposed that the differential between the rates collected from customers by SDG&E, and the price SDG&E paid to producers, be tracked by a “balancing account,” but did not propose how the balancing account would be reconciled over time. The proposal generated significant support, but also controversy. The petition was granted in part by the CPUC by capping monthly bills for customers, but the state legislature took up the issue with the adoption of AB 265. That bill capped rates (as opposed to monthly bills) for SDG&E customers through December of 2002, requiring the creation of the balancing account, but also failed to address how the balancing account would be treated upon its termination. Thus, it remains unresolved which party or parties will bear some or all of the impact of the undercollection for the cost of electricity; SDG&E, its customers, electricity producers, or the state.

In July of 2000, the San Diego City Council adopted a resolution declaring a state of emergency in San Diego as a result of the energy crisis. A copy of that resolution is enclosed as Attachment B. The resolution called for; 1) a reasonable rate freeze; 2) FERC to regulate wholesale electricity rates at a reasonable level; 3) the State Attorney General to investigate possible collusion and price fixing; 4) the expeditious siting of new power plants and transmission facilities; and other actions believed necessary to begin addressing the crisis.

II

THE CITY’S PARTICIPATION IN THE REGULATORY PROCEEDINGS

A. The Federal Proceedings.

In response to the California crisis, a number of proceedings were instituted at FERC, by both FERC itself and other interested parties. These proceedings have more or less been consolidated into one matter, with the primary FERC docket numbers of EL00-95-000, EL00-95-002 and EL00-95-003. The matters which have been reported in the local news as arising out of FERC have all been related to these consolidated cases.

In light of the need to be a party to these proceedings, and in cooperation with the City Manager, the City Attorney sought out experienced counsel to assist the City at both FERC and the CPUC. Following a necessarily quick but thorough search, the City retained the services of Miller, Balis & O’Neil of Washington D.C., an experienced and highly recommended law firm in the area of utility regulation, and Sara Myers, Esq., a highly recommended former staff attorney and administrative law judge with the CPUC. In addition, the City continues to retain the services

of MRW & Associates as consultants in the energy field, and the City Attorney and City Manager have designated and funded a deputy city attorney to work full-time on these regulatory proceedings.

In the fall of 2000, FERC gave direction to its staff to prepare a report on the California situation. The report was issued on November 1, 2000, and FERC issued on the same day a draft order setting forth proposed remedies. A copy of the Introduction and Summary of the November 1 order is enclosed for your review as Attachment C. The significant aspects of the order were its direction that the IOUs not be required to sell into or buy from the California Power Exchange [PX]; that changes be made in the structure of the governing boards for the PX and Independent System Operator [ISO]; the establishment of a \$150 MWh “soft cap” for wholesale electricity; and its failure to order refunds of wholesale rates FERC characterized as “unjust and unreasonable” in the summer of 2000.

Interested parties were invited to file comments on the proposed order, and the City filed extensive comments focusing primarily on the need to impose cost-based wholesale rates where necessary and contending that FERC not only has the authority but the obligation to order the disgorgement of unjust and unreasonable profits. The full filing by the City has been provided to the Committee, but the first seven pages of the filing, which summarize the City’s positions, are enclosed with this Report as Attachment D.

FERC issued its final order on December 15, 2000. That order did not change in any significant way from the November 1 order. A copy of the Introduction and Summary are enclosed as Attachment E. In late December the City filed a Petition for Review of the FERC order in the Ninth Circuit Court of Appeals, the federal appellate court with jurisdiction in California. We anticipate challenging a number of aspects of the order in court, and briefs are due in the spring, however, we also anticipate that FERC will move to dismiss the petition as premature, contending that its order is not really “final” at this time. In a related matter, SCE filed a similar petition, but requesting immediate relief, in the District of Columbia Circuit Court of Appeals, which also has jurisdiction over FERC orders. As was reported in the paper recently, the D.C. Circuit denied the requested relief. That order has no direct bearing on the City’s petition. Similarly, a petition for immediate relief from the FERC order has been filed by the ISO in the Ninth Circuit. The court has not yet acted on that petition.

Also in late December, Mayor Murphy sent a letter to Secretary of Energy Richardson, urging the Secretary to continue the use of his emergency powers requiring producers to sell electricity into the California market, but also asking that he impose cost-based rates in the wake of FERC’s failure to address the wholesale rate issue. In addition, the Mayor asked the Secretary to begin investigating the effect of market manipulation on the cost of natural gas, which itself has been rising rapidly under questionable circumstances. A copy of the Mayor’s letter is enclosed as Attachment F.

At this point, there will be further proceedings before FERC, but the main issues remain embodied in the December 15 order. It is anticipated that a number of parties to the proceedings will pursue review of the significant aspects of the order in the courts.

B. The California Proceedings.

As with at FERC, a number of proceedings and investigations have been commenced before the CPUC, and the City has intervened in the significant cases. Most immediate, however, is the recent proceeding in which some rate relief was granted to both SCE and PG&E. Both companies sought relief from the price cap in effect, which would allow them to collect more from customers off-setting the large amount of the current undercollection accumulating in the balancing account for each. As has been reported in the paper, these IOUs claimed that the severe undercollection in the balancing account would drive them into bankruptcy. The CPUC granted some relief, but not as much as the utilities requested. SDG&E has signaled that it, too, will be requesting relief from the price cap recently imposed by AB 265 for the same reasons.

C. Other Actions.

As directed in the July, 2000, resolution, City staff has begun exploring a variety of options available to the City to control its energy future. These include "aggregation," a process by which a number of large or small users collectively purchase power and in which the economies of scale should result in lower costs, as well as the formation of a public utility district for the generation, purchase and distribution of power. Each of these options present a complex set of issues for debate and discussion. An article appearing in the January, 2001, issue of *Governing* magazine describes the experience of other jurisdictions in these areas. A copy of that article is enclosed as Attachment G. City staff will report back as directed regarding these options at a future time.

III

RECOMMENDATIONS

In addition to the matters set forth in the July, 2000, resolution, the City Attorney and City Manager recommend the following at this time:

1. That the City's legal team aggressively pursue all remedies at FERC and the CPUC to ensure the reliable supply of electricity and natural gas at reasonable prices, such remedies to include pursuing review of any applicable orders in federal or state court. The City's legal team will seek direction from the City Council at the appropriate times regarding specific positions to be taken in the proceedings;

2. That the City Manager and City Attorney simultaneously work with IRD to formulate, recommend and support necessary legislation in Sacramento and Washington D.C. to accomplish the same goal in the event that the regulatory agencies abdicate their responsibility or to the extent that those agencies do not have jurisdiction to implement effective measures. Once formulated, such proposals will be presented to the City Council for review and approval;
3. That the City implement the Mayor's recommendation for the creation of a City "energy czar" to oversee the City's efforts at energy self-reliance and efficiency; and
4. That City Manager and City Attorney analyze and report back to the City Council on viable options for energy self-sufficiency such as aggregation or the formation of a public utility district.

CONCLUSION

There are no simple answers to the complicated problems arising from the flawed attempt to deregulate the electricity market in California. The City is actively involved in the variety of proceedings attempting to address the issues and formulate remedies. The recommendations made in this Report, if implemented, should help address the energy problems facing the San Diego region, and help reduce the hardships experienced by San Diego's citizens as a result of the "unjust and unreasonable" prices FERC has found to be charged for electricity, but for which it has implemented no meaningful remedies.

Respectfully submitted,

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By

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Attachments (A-G)
cc: City Manager
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